Exempt From Scrutiny: Tax Breaks in Ohio

Executive Summary

Tax expenditures – exemptions, deductions and credits that cause taxes not to be paid when they would be otherwise – often are overlooked in state budget deliberations. Yet as the Ohio Department of Taxation has noted, they have the same fiscal impact as direct expenditures. The taxation department estimated in its regular report on tax expenditures two years ago that they would total $6.27 billion in fiscal 2006 and $7.12 billion this fiscal year. Though the major tax reform enacted in 2005 changed the value of many exemptions, such expenditures are a significant element in Ohio's state budget, compared with actual state tax revenue of $20.8 billion in FY06. They should be considered in the budget process.

Ohio's tax expenditures not only affect a very substantial share of the state's tax base. Aside from a biennial review of state revenue losses, they receive no regular scrutiny though many have been in effect for decades. Since 1963, brewers and beer importers have gotten a credit on beer and malt beverage taxes for paying part of them a few weeks in advance. The largest tax expenditure, estimated to be worth more than $2 billion a year, exempts machinery, equipment, supplies and fuel used in manufacturing from sales and use taxes. It was last overhauled in 1990. Many tax expenditures like the manufacturing exemption have a reasonable basis, but still need a regular review.

Numerous tax expenditures are aimed at economic development, yet we have little idea of who is getting them or whether they are providing the benefits one would demand of a grant or other outright expenditure. These include a sales and use tax exemption for equipment used in warehouses when the product is primarily shipped out of Ohio to certain customers, worth an estimated $6.9 million this fiscal year. In 2003, the General Assembly also capped at $800 the amount of sales tax paid on each jet aircraft purchased in fractional shares by wealthy Ohioans. These and other tax expenditures should find their way into the unified budget for economic development that Gov. Ted Strickland promised in his campaign. The budget should require disclosure of who is benefiting from these expenditures and what beneficiaries provide in return over time.

Some tax expenditures provide an advantage to one industry or even one company, which may disadvantage other companies or industries. For instance, products sent to distribution centers with more than $500 million in annual supplier costs that ship at least half their product out of state are exempt from the new Commercial Activity Tax. Just one distribution center has claimed the exemption. A cap on the amount of corporate franchise tax paid under the net-worth formula is available only to companies with $37.5 million or more in net worth. Smaller companies need not apply.

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The CAT tax was supposed to be an antidote for the two taxes it is replacing, the loophole-ridden corporate franchise tax and the often-abated tangible personal property tax. But while the disappearance of these two taxes does mean loopholes will disappear with them, the General Assembly added or extended more than a dozen exemptions or credits to the CAT that will be worth more than $200 million a year. That does not include tax credits worth hundreds of millions of dollars over 20 years for unused net operating loss deductions against the corporate franchise tax. These credits will be available only to companies with large losses.

A number of other states go further than Ohio and include in their tax expenditure reports the purpose of each expenditure, analysis of the effectiveness with which that purpose is being accomplished, and data on the number and type of taxpayers who are benefiting. Others review how much certain tax expenditures benefit taxpayers according to their income level. The Ohio Department of Taxation should receive additional funding in the budget to hire research staff and closely analyze tax expenditures on each of these issues, going beyond the report it will release as a part of the governor's proposed budget.

The Strickland administration should ask for recommendations from the taxation department and other departments on which tax expenditures no longer serve Ohio and should be slated for elimination in the upcoming FY2008-2009 budget. The General Assembly should also schedule hearings on tax expenditures as part of its consideration of the upcoming budget. Existing and new tax expenditures should be subject to a limited term and a regular review.

Ohio's biennial tax expenditure report is a useful tool for understanding the tax system and its exemptions, credits and deductions. However, this tool needs to be sharpened and used more effectively.

Policy Matters Ohio *is a non-profit, non-partisan research institute dedicated to researching an economy that works for all in Ohio. Policy Matters seeks to broaden debate about economic policy by providing research on issues that matter to Ohio's working people and their families. Areas of inquiry for Policy Matters include work, wages, and benefits; education; economic development; energy policy; and tax policy. Generous funding comes from the Joyce, Gund, Cleveland and St. Ann Foundations and the Economic Policy Institute. To those who want a more fair and prosperous economy… Policy Matters.*

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